LOS ANGELES BAR BULLETIN

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LOS ANGELES
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VOL. 23 DECEMBER, 1947 No. 4

A WORD FROM THE PRESIDENT

NEW members of our Board of Trustees are often surprised both by the volume and the varied nature of the work of the Board.

The volume is indicated by the fact that the Board normally meets once a week and devotes from an hour and a half to two hours to each meeting. Even so, the Board could not dispose of its business except for the careful prior work of the committees of the Association.

The varied nature of the work of the Board may be illustrated by the fact that in recent weeks it considered and acted upon the following matters:

—approved the request of the American Bar Association that our Association cooperate in sponsoring the forthcoming Los Angeles visit of the Freedom Train.

—appointed a special committee, on the recommendation of the Association's Committee on New County Court House, to present to the Board of Supervisors the great need for additional court rooms.

—named L. B. Binford to fill the vacancy on the Board of Trustees arising from the resignation of Judge Philip H. Richards.

—adopted the policy of cooperating with the State Bar and the University Extension Division of the University of California in their proposed 1948 lecture program for continuing education of the bar.

—approved the view of a special committee of the Association that the Presiding Judge of the Superior Court should be chosen by the judges on the basis of particular qualification for the duties of that office, rather than on the basis of seniority alone.

—considered, at the request of the Judicial Council, and referred to the Association's Committee on Pleading and Practice for detailed study, proposed revised rules for the Superior Court.

—approved twenty-one applications for membership and eighteen applications for reinstatement of membership in the Association.

—determined, at the request of the Chairman of the BULLETIN Committee, the policy to be followed as to the publication of articles on non-legal subjects.

—approved and referred to the Association's delegation to the State Bar Conference, committee reports recommending changes in code sections relating to practice and procedure.

Paul Fussell

BY THE BOARD

Court on the Judiciary: A copy of a concurrent resolution of the New York Senate and Assembly was presented to the Board which, if enacted into law, will create a "Court on the Judiciary" with power to retire judges for cause. The resolution was sent to the Association's Committee on the Judiciary for study and to make its recommendations to the Board.

Traffic Court: The Board adopted a resolution approving the resolution of the Traffic Court Committee of the Association, and ordered both resolutions sent to the Board of Supervisors with the request that they be given consideration. The Traffic Court Committee's resolution recommended that the Municipal Traffic Courts and Traffic Fines Bureau be not removed from

their present quarters in the City Hall to 232 Market Street for the reason that the latter location and the building are entirely unsuitable and inadequate. It recommends that the Traffic Courts and the Fines Bureau be retained in their present location until the Supervisors are able to provide suitable and adequate quarters at a location outside the central traffic district where parking facilities can be made available.

Court House: A resolution was adopted for a committee composed of President Paul Fussell, Emmett Doherty, Chairman of the Committee on New County Court House, and Frank Weller, trustee, to present to the Supervisors the dire need for a Municipal Courts building.

E. D. M.

WHY LAWYERS SHUN POLITICS

By James Ray Files, of the Los Angeles Bar

THE thoughtful and illuminating article on "The Lawyer in Politics," by Bernard C. Brennan, published in the September BAR BULLETIN, stresses the great need to have more lawyers and better lawyers in public service and political office. The point is well taken, for all the reasons urged—and more. While he seeks an admirable end, he fails to point the easy solution.

While the modern poll may mirror the public mind, it does not make cowards of candidates who are not already cowards. Every public officer would like to know what his constituents are thinking and in a representative government he should give respectful consideration to their wishes. To that extent the poll is a useful adjunct to modern politics. The poll is not primarily responsible for the average ability of public men sinking below the level of mediocrity.

Both Lincoln and Douglas, we may assume, were as much interested, and properly so, in feeling the public pulse as any modern candidate, good or bad. Both of these eminent lawyers wanted very much to be elected to the Senate. Both knew that, potentially, the presidency might be the stake. But neither man created the public opinion of his day. That had been a century in forming. Every successful candidate—then and now—is the product of the events and the opinion of his time. Both men disliked slavery and regarded it as a cancerous growth.

Lincoln knew that a popular and powerful revulsion had developed against the institution of slavery. He was sympathetic to that view. He took the bold position and hopefully believed that public opinion would sustain him. He believed and said that "a house divided against itself cannot stand"; that "if slavery is not wrong, nothing is wrong"; that slavery was on its way to extinction. Douglas, like Taney who wrote the Dred Scot Decision, believed that slavery was primarily a property question. Lincoln saw the change in public opinion. The people who elected him saw it. But Douglas had no conception of the tide that had set in; he was obedient to a day that was gone. The parade of public opinion had passed him by—and he didn't know it.

Men have not changed much. No, the poll has not made lawyers shun politics; the poll has not given us our "bramble" leaders.

But lawyers of fine training and integrity usually shun politics, at least to the extent of standing for office, as they would avoid a plague. The answer is as regrettable as it is simple. The same answer applies to successful and outstanding men in other professions; *the primary.*

We have heard of crooked caucuses and corrupt conventions. Railroads once dominated party officers and party organizations. But that day is gone and it can never return. Indeed, the primary, or the convulsion that gave us the primary, may have been largely responsible for that riddance. We have paid a staggering price for the change.

When we vote at a primary—particularly a California primary—we choose from a group of ambitious volunteers. No one vouched for any of them. They cross file, so that political identity is lost. Often candidates are elected on both tickets and then even party responsibility and party accountability go glimmering. Not one voter in 10,000 has a personal acquaintance with a new Governor or Senator. It is amazing that we occasionally get a good man.

It might be advisable to retain a modified primary, but let each party name one candidate for each office to be filled; allow that candidate to head his party ticket, designated as "Recommended By Convention." Then if any brave soul should feel

called to office, let him file as now, to contest with the convention nominee. This would at once constitute a safety valve, and would have a salutary tendency to keep conventions clean. Voters would soon learn that closets had been searched, that men of integrity and ability had been sought out to stand for public office, and that they had been vouched for by responsible party organizations. Really, it never hurt anybody to have his character vouched for by some one of responsibility.

Our ablest and most successful lawyers have a keen regard for public service, but they have no stomach for the kind of competition they must meet when they enter a wide open primary. Let the uniform high quality of lawyers being persuaded to accept positions on the bench be a lesson from which we may profit. It is no reflection on democracy to remember that it functions best when it is an informed democracy. To get the most out of it we must give more attention to the process of selectivity.

PATENTS AND THE FEDERAL INCOME TAX

By Martin H. Webster, of the Los Angeles Bar

BUSINESS dealings with patents usually take on the following chronological pattern: first, the acquisition or development of the patent; then the holding of the patent for a period during which certain expenses are incurred; and finally the disposition of the patent either by sale or through the economic processes which completely destroy its value. This article will discuss the tax consequences of each step in that order.

ACQUISITION OR DEVELOPMENT

If a taxpayer purchases an already issued patent from some third person, the purchase price is of course not deductible in the year made, any more than would the purchase price paid for a business or shares of stock be deductible.

A similar result obtains if a taxpayer, by dint of his own efforts and ingenuity, develops a patentable invention himself. His cost of materials and labor, his expenses in clearing title and filing an application for a patent, his Government fees, his costs

in any interference proceedings that might arise while his application is pending, are all part of his total cost.[1]

Research, experimental and development costs may be either capital in nature or chargeable to expense depending upon the facts.[2]

If, in the case of the taxpayer who develops his own invention, his application for a patent eventually meets with failure, it seems safe to assume that the expenses incurred in connection therewith may be deducted as a loss in the year in which the patent application is denied.[3]

PERIOD PRIOR TO DISPOSITION.

A. DEPRECIATION. A depreciation deduction is allowed in each year the patent is held in an amount equaling 1/17 of the cost, commencing with the year the patent is granted.[4]

In connection with this deduction for depreciation, there are several important points:

(1) The depreciation must be taken on the basis of the legal life of the patent, even though it is reasonably felt but not conclusively shown that the useful life of the patent might be for a shorter period.[5] (2) The depreciation deduction is not allowed during the period when and application is pending, and only commences in the year when the patent is granted.[6] (3) Where there are several patents dependent upon a basic patent, depreciation on these ancillary patents is allowed on the remaining life of the basic patent.[7] (4) If depreciation is not taken in the early years of a patent, depreciation may later be taken, although its annual amount will be computed as if the deduction had been taken over the entire life of the patent.[8] (5) Where a patent is acquired by bequest, devise or inheritance, the depreciation deduction will be taken on the fair market value of the

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[1]Addressograph-Multigraph Corp., TC Memo Op., CCH Dec. 14, 387 (M); Claude Neon Lights, Inc., 35 BTA 424; Buffalo Forge Co., 5 BTA 947; Gilliam Mfg. Co., 1 BTA 967.

[2]See 474 CCH Std. Fed. Tax Reporter, par. 8693.

[3]Internal Revenue Code, Sec. 23 (e) and (f).

[4]Regulations 111, Sec. 29.23 (1)-7.

[5]*Hazeltine Corp. v. Com'r*, 89 F. (2d) 513 (CCA 3rd, 1937).

[6]*Twin Disc Clutch Co.*, 2 BTA 1327.

[7]*National Piano Mfg. Co.*, 11 BTA 46.

[8]*Deltox Grass Rug Co.*, 7 BTA 811; *Burke Electric Co.*, 5 BTA 553.

patent as of the date of such acquisition[9] and spread over the remaining legal life of the patent.

B. OBSOLESCENCE. If unforeseen circumstances, such as scientific progress or changed economic conditions, make it apparent that the useful life of a patent will be cut short, a deduction in addition to depreciation may be taken in order to accelerate the writing off of the cost of the patent.[10] This increased deduction is referred to as obsolescence. As an example, if after 7 years it is discovered that a patent costing $17,000 and for which an annual depreciation deduction of $1,000 is taken ($17,000 divided by 17 years) will have a remaining useful life of only 5 more years, the remaining undepreciated cost of $10,000 ($17,000 less $7,000) may be written off in the remaining 5 years by adding to the $1,000 depreciation deduction an annual deduction for obsolescence of an additional $1,000.

C. INFRINGEMENT PROCEEDINGS. Legal[11] and accounting[12] fees paid by a defendant in an infringement suit are generally deductible as ordinary and necessary business expenses in the year paid,[13] although whether such expenditures are capital items or deductible expenses is a question of fact concerning which no hard and fast rule can be laid down.[14] Damages paid pursuant to judgment are also deductible,[15] but only in the year when judgment is rendered.[16] Amounts paid in settlement of an infringement suit, although not pursuant to judgment, are also deductible items.[17]

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[9]Internal Revenue Code, Sec. 114 (a) and 113 (a) (5).

[10]Regulations 111, Sec. 29.23 (l)-6; *Hazeltine Corp. v. Com'r, supra* note 5; *O'Neill Mach. Co.*, 9 BTA 567.

[11]A.R.R. 98, 2 C.B. 105; *cf. Allen & Co.*, TC Memo Op., CCH, Dec. 13,126 (M).

[12]*Meyer & Bros. Co.*, 4 BTA 481.

[13]*Supra*, note 12.

[14]*Addressograph-Multigraph Corp., supra*, note 1.

[15]*Becker Bros. v. U. S.*, 7 F. (2d) 3 (CCA 2nd, 1925).

[16]*Peck, Stow & Wilcox Co.*, 12 BTA 569; *Safe Guard Check Writer Corp.*, 10 BTA 1262.

[17]*Ward v. U. S.*, 32 F. Supp. 743 (1940).

Where the patent owner is the plaintiff in an infringement suit, damages recovered by him are income when received,[18] against which of course he is allowed to deduct his legal and accounting costs.

DISPOSITION OF PATENT

A. BY SALE.

1. *Gain or Loss.* The gain or loss on disposition of a patent is determined by computing the difference between the selling price and the cost or other basis, with proper adjustment for depreciation.[19] If the patent is a capital asset in the hands of the taxpayer,[20] the capital gain and loss limitations are applicable.[21] Furthermore, when the patent, a depreciable asset, is used in the trade or business of the taxpayer and is held for more than 6 months, the long term capital gain tax limitation of an effective rate of 25% may be enjoyed under IRC, Sec. 117(j), even though the patent is not a capital asset. If the patent is not a capital asset, and IRC, Sec. 117(j), does not apply, the gain or loss on disposition would be fully taken into account as ordinary income or loss.

2. *Installment Sales.* Where the taxpayer is in the business of selling patents, or where the taxpayer makes a casual sale of a patent and (1) the price is more than $1,000, and (2) the initial payments do not exceed 30% of the selling price, it might be profitable, under certain circumstances, to elect to treat income received on an installment sales basis.[22] Under this basis, the profits from a sale may be taxed over the period of years covered by the installment payments based upon the amount of profit which is realized from each such payment. To illustrate, if the depreciated basis of a patent is $5,000 at the time of sale,

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[18]*Triplex Safety Glass Co. of N. A. v. Latchum,* 131 F. (2d) 1023 (CCA 3rd, 1942); *W. W. Sly Mfg. Co.,* 24 BTA 65.

Where, however, the individual buys a patent and with it the right to damages in a suit then pending, the ultimate receipt of damages will not constitute income, since the right to damages was part of the purchase price.—*Hyatt Rolls Bearing Co. v. U. S.,* 43 F. (2d) 1008 (Ct. of Claims, 1930).

[19]Regulations 111, Sec. 29.22 (a)-9.

[20]Internal Revenue Code, Sec. 117 (a) (1).

[21]Internal Revenue Code, Sec. 117.

[22]Internal Revenue Code, Sec. 44.

and the selling price is $10,000, this means that for every dollar received by the seller, 50 cents or 50 per cent is profit. Accordingly, if the contract of sale provides that $2,000 will be paid immediately, and the balance of the purchase price will be paid in four equal annual installments of $2,000, and if the seller finds it advantageous to do so, he may elect to report only $1,000 as taxable income in each year. The tax saving can be very substantial in appropriate cases by the use of this method, and contract terms should be carefully drawn to allow the method to become operative where desired.

3. *Compensation for Work Covering 36 Months or More.* Until recent years, inventors who worked for long periods of time without pay and then received their full compensation upon the completion of their undertaking were taxed fully in the year in which payment was received. This often resulted in severe hardships. Accordingly, the 1942 Revenue Act sought to correct this situation for inventors, authors, composers and the like, by enactment of Section 107(b) of the Internal Revenue Code, effective for taxable years beginning after December 31, 1941. This section is interpreted to mean that, in the case of work done by an individual on a patented invention covering a period of 36 months or more, the tax on income received in a given tax year from the invention shall not be more than the total taxes would have been had the income been received ratably over the period representing that part of the work which had been completed prior to the close of the taxable year, or a period of 36 months, whichever of such periods is the shorter. This ceiling on the tax to be paid becomes effective only if the income received on an invention in the taxable year is 80 per cent or more of all amounts received in prior years, in the taxable year, and in the twelve months next succeeding the taxable year. The section does not apply to income received as a long-term capital gain, which, as was discussed above, already has a 25 per cent ceiling.

A series of examples will assist to illustrate the operation of this section:*

*In each example, it will be assumed that A is an individual who makes his returns on a calendar year basis, and on the basis of cash receipts and disbursements, and that he is not in the business of selling inventions (*i.e.*, the long-term capital gains provisions do not apply).

(1) On October 1, 1942, A receives a down payment of $1,000 on the sale of a patent the work on which was commenced on September 1, 1940, and completed on January 31, 1944. Further installments are due in equal amounts for the next five years following 1942. This is not a Section 107(b) case, since less than 80 per cent of all amounts paid will have been received in any one taxable year.

(2) On November 30, 1943, A receives $36,000 in full payment for the sale of a patent the work on which was commenced on September 1, 1940, and completed on January 31, 1944. This is a Section 107(b) case since in the taxable year 1943 A receives at least 80 per cent of the total payments to be made. Accordingly, the tax attributable to the $36,000 received in 1943 shall not be greater than the tax attributable to such amount had it been received ratably over the calendar months from September 1, 1940, to December 31, 1943 (the close of the taxable year in which work was performed). The specific allocation to each year of the $36,000 received would be as follows: The period of work covers 41 calendar months, but allocations can be made to only the last 36 calendar months which precede the close of the current taxable year. Therefore, $1,000 ($36,000 divided by 36) must be allocated to each of the calendar months preceding January 1, 1944. Accordingly, $12,000 is allocated to 1941, $12,000 to 1942, and $12,000 to 1943.

(3) Assume the same facts as in Illustration (2), except that work was commenced in July, 1942, and completed November 30, 1945. Although the period of work covers 41 calendar months, allocations may be made to only the 18 calendar months which are included within the part of the period of work which precedes the close of 1943 (the current taxable year). Therefore, $2,000 ($36,000 divided by 18) must be allocated to each of 18 calendar months preceding January 1, 1944. Accordingly, $12,000 is allocated to 1942, and $24,000 to 1943.

(4) On November 30, 1945, A received the sum of $36,000 in full payment for the sale of a patented invention the work on which was commenced on September 1, 1942, and completed on October 1, 1945. Although the period of work covers 37 calendar months, allocations may be made to only the 36 calendar

months preceding the date of completion of the work. Therefore, $1,000 ($36,000 divided by 36) must be allocated to each of the 36 calendar months preceding October 1, 1945. Accordingly, $3,000 is allocated to 1942, $12,000 to 1943, $12,000 to 1944, and $9,000 to 1945.

(5) Assume the same facts as in Illustration (4), except that payment was made on January 1, 1946. Here payment was made in a taxable year different from the one within which work was completed. This nonetheless appears to be the kind of case covered by Section 107(b). Accordingly, the tax attributable to the $36,000 received in 1946 shall not be greater than the tax attributable to such amount had it been received ratably over the calendar months during which the work was performed, not to exceed 36 months. The specific allocation would therefore be as follows: $3,000 in 1942, $12,000 in 1943, $12,000 in 1944, and $9,000 in 1945.

Once specific allocation has been made, pursuant to Section 107(b), it becomes necessary to determine the tax attributable to the income in the year received; this tax cannot be greater than the total of the taxes which would have been paid on this income had it been allocated over earlier years. This is done in the following manner:

Total tax in current taxable year including all income from invention

Line 1 Less: Tax in current taxable year excluding income from invention

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Line 2 Tax attributable in current taxable year to income from invention

Total tax in current and prior years including allocated income from invention

Less: Tax in current and prior taxable years excluding allocated income from invention

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Line 3 Total tax payable had income from invention been allocated

The tax payable in the current taxable year is the sum of Line 1 and the smaller of Lines 2 or 3.

A ruling[23] of the Income Tax Unit, Treasury Department, provides that Section 107(b) contemplates that expenses incurred in earning income should be treated as if ratably paid over the same period as the income was earned. This ruling will affect the above computation.

B. BY ABANDONMENT.

Where there is disposition not by sale but by abandonment, the Internal Revenue Code makes no distinction as to whether the asset is or is not a capital asset. A deduction is allowed for the full loss.[24]

To constitute abandonment, there must be an intent to abandon coupled with some decisive act evidencing this intent.[25] The cause of abandonment must be some sudden event or happening which prematurely and unexpectedly terminates the useful life of the asset.[26] This loss for abandonment is fully deductible only in the year of actual abandonment.[27]

It is settled that the deduction for loss by abandonment applies not only to patents but also to patent rights.[28] A question has arisen as to whether there may be some residual value to the abandoned patent, or whether there has to be a complete uselessness before the loss may be allowed.[29] Early cases have expressed the view that there can be no residual value.[30] However, the present Treasury Department Regulations appear to contemplate an abandonment loss where there may yet be some salvage or scrap value to the patent abandoned.[31] The question becomes acute where a patent is "sold" for its scrap or salvage

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[23]I.T. 3773, 1945 C.B. 151.

[24]Regulations 111, Sec. 29.23 (e)-3.

[25]Mertens, "Law of Federal Income Taxation," Sec. 28.18, 28.19 and cases cited.

[26]Regulations 111, Sec. 29.23 (e)-3.

[27]*Liberty Baking Co. v. Heiner*, 37 F. (2d) 703 (CCA 3rd, 1930).

[28]*Connecticut National Pavements, Inc.*, 3 BTA 1124.

[29]See discussion Mertens, *supra*, note 25, Sec. 28.17; 471 CCH Standard Federal Tax Reporter, Par. 197.01.

[30]*Consolidated Window Glass Co.*, 1 BTA 365.

[31]Regulations 111, Sec. 29.23 (e)-3.

value. Is this a sale or exchange, such that if appropriate the capital loss limitations apply? Or is this an abandonment of all but the residual value, such that a full loss, less the salvage value recovered is deductible? There is no clear-cut answer to this question.[32]

C. By Assignment of Royalty Contract.

In two recent cases, the Tax Court[33] and the 8th Circuit Court of Appeals[34] have sustained the validity of assignments of royalty contracts to shift the tax burden thereof from the assignor to the assignee. Both cases involved transfer by a husband to a wife and represent possible tax-saving avenues. The decisions have been questioned, in view, particularly, of two Supreme Court cases,[35] and should be approached with some caution until more emphatically established.[36]

CONCLUSION

Tax avoidance, which the author likes to refer to as tax "saving," is a legitimate realm within which the ingenuity of an individual may be translated into actual dollars. Particularly with respect to installment sales and compensation for work performed on an invention for a period of 36 months or more, and possibly by assignment of royalty contracts, a taxpayer has the opportunity to effect tax savings for himself which should not be overlooked.

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[32] *Supra*, note 30.

It would appear to be a fully deductible loss where the taxpayer writes down the depreciated cost of the patent on his books to its present estimated salvage value, and in a separate—though almost simultaneous transaction, sells it for its scrap or salvage value.

[33] *Strauss*, 8 TC No. 121.

[34] *Sunnen v. Com'r*, 161 F. (2d) 171 (CCA 8th, 1947); *accord Lum v. Com'r*, 147 F. (2d) 356 (CCA 3rd, 1945). Certiorari was granted in the *Sunnen* case October 13, 1947.

[35] *Helvering v. Horst*, 311 U. S. 112 (1940); *Helvering v. Eubank*, 311 U. S. 122 (1940).

[36] Casting doubt on general acceptance of the doctrine is *Midwood Associates Inc. v. Com'r*, 115 F. (2d) 871 (CCA 2nd, 1940).

SOME RECENT SIDE LIGHTS ON THE COMPULSORY PRODUCTION OF REQUIRED RECORDS

By H. Eugene Breitenbach*

THE problem of how to obtain, for use in litigation, the information contained in records required by law to be kept for inspection by governmental regulatory agencies, without running afoul of the Fourth or Fifth Amendments to the Federal Constitution, or their counterparts in state constitutions, has caused many official headaches.

Likewise, the conscientious private practitioner is often perplexed by the problem of correctly advising his clients concerning the maintenance or disclosure of required records.

Obviously, the measure of advisable voluntary disclosure may frequently depend upon the extent to which disclosure may be compelled.

Therefore, frankly facing the adversary nature of litigation, some knowledge of the circumstances under which disclosure may be compelled, and the consequences of a denial of such disclosure may be of considerable value to certain clients.

The problem is becoming increasingly familiar in those manifold situations where the law regulates that which it seeks to investigate, and has increased in importance with the great increase in regulatory legislation containing record-keeping requirements. World War II spawned a great volume of so-called emergency legislation, implemented by detailed regulations touching nearly every phase of American life.

Anyone who has experienced the doubtful pleasure of attempting to enforce such statutes and regulations, even against violators conditioned by wartime patriotism, may have cause to contemplate some of the fundamental principles which often undergird day to day enforcement skirmishes.

It is a well-known fact that false or inadequate records are frequently the starting point for violation, as well as the detection of contravention, of governmental regulations.

The amusing, but actual, incident of the business firm member who kept three sets of account books—one set to show to his creditors; another set to show to the government; and still

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another set to show to his partners, became an all too common war-time phenomenon.

CONSTITUTIONAL PROVISIONS CREATE CONFLICT OF INTERESTS

The primary constitutional issues involved are elementary but basic and far-reaching.

The United States Constitution, Amendment IV, provides:

> "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

Amendment VI provides, in part:

> "No person shall . . . be compelled in any criminal case to be a witness against himself, nor to be deprived of life, liberty, or property, without due process of law . . ."

The conflict of social needs or interests created by these "bulwarks of liberty" is clear and inescapable.

As Mr. Justice Cardozo pointed out in *People v. Defore,* 242 N. Y. 13, 24:

> "On the one side is the social need that crime shall be repressed. On the other, the social need that law shall not be flouted by the insolence of office. There are dangers in any choice."

In this connection, the following caveat of Judge Learned Hand in *U. S. v. Kirschenblatt,* 16 Fed. (2d) 202, 203 (C. C. A. 2d, 1926), should not go unheeded:

> "Nor shall we forget that what seems fair enough against a squalid huckster of bad liquor may take on a very different face, if used by a government determined to suppress political opposition under the guise of sedition."

Its ramifications are so varied that only a few principal facets of the so-called required records problem can be examined in this article.

FUNDAMENTAL PRINCIPLES INVOLVED

Thus, certain fundamental principles should be recalled at the outset:

Private papers and documents obtained by federal officers as a result of an unreasonable search and seizure in violation of the Fourth Amendment are not admissible in federal courts when timely objection is made by the aggrieved person.

Boyd v. U. S., 116 U. S. 616;

Weeks v. U. S., 232 U. S. 383.

The reasonableness of the search depends on the facts of the case.

Harris v. U. S., 328 U. S. 832;

Go-Bart v. U. S., 282 U. S. 344.

Under certain circumstances, as Mr. Justice Cardozo pointed out in *People v. Defore*, 242 N. Y. 13, "The criminal is to go free because the constable has blundered."

While this rule of nonadmissibility of illegally obtained evidence was apparently developed in the federal courts as the best way to effectuate the safeguards of the Fourth Amendment (*Nueslein v. Dist. of Col.*, 115 Fed. (2d) 690, 694, 695 (App. D. C., 1940, Vinson, J.), both at common law and by the weight of authority among the state courts, such evidence is admissible.

8 *Wigmore on Evidence*, 3rd Ed., 1940, Sec. 2183, 2184;

People v. Defore, 242 N. Y. 13.

Criminal or civil actions to restrain over-zealous officers are infrequent, and inadequate.

Nueslein v. Dist. of Col. (*supra*, at p. 695).

Recovery of damages caused by federal officers violating the Fourth and Fifth Amendments has recently been denied in a well-reasoned opinion of Judge Mathes. *Bell v. Hood*, 71 Fed. Supp. 813 (D. C., S. D. Cal., May 2, 1947).

"Witness" is the keyword. A witness is protected from producing his private records in response to a subpoena *duces tecum*, for his production of them in court would be his voucher of their genuineness. There would then be "testimonial compulsion."

Haywood v. U. S., 268 Fed. 795, 802.

Courts have recognized a category of "quasi-public" records which are protected to a lesser degree than private papers.

Wilson v. U. S., 221 U. S. 361;

Bowles v. Glick Brothers Lumber Co., 14 Fed. (2d) 566.

Corporations are not within the protection of the Fifth Amendment and while a corporate officer is protected in his individual capacity by the self-incrimination provisions of the Fifth Amendment, the immunity does not extend to corporate records in his possession.

Wilson v. U. S., 221 U. S. 361.

Corporations are protected against an unreasonable search and seizure under the Fourth Amendment, even if they be not

protected by the Fifth Amendment from compulsory production of incriminating records.

Silverthorne Lumber Co. v. U. S., 251 U. S. 385.

However, both corporate and individual papers and records required to be kept by statute and subject to the visitorial powers of the federal government are held subject to production in response to a subpoena.

Wilson v. U. S., 221 U. S. 361 (Sherman Anti-Trust Act);

Rodgers v. U. S., 138 Fed. (2d) 992 (Agricultural Adjustment Act of 1938);

Oklahoma Press Pub. Co. v. Walling, 327 U. S. 186 (1946) (Wages and Hours Act).

Such records may be subject to administrative inspection at the place of business.

Bowles v. Glick Brothers Lumber Co., 146 Fed. (2d) 566 (C. C. A. 9th, 1945);

Bowles v. Beatrice Creamery Co., 146 Fed. (2d) 774 (C. C. A. 10th, 1944).

Likewise, an administrative inspection order will be enforced by the courts.

Porter v. Gantner & Mattern Co., 156 Fed. (2d) 886 (C. C. A. 9th);

Bowles v. Northwest Poultry & Dairy Products Co., 153 Fed. (2d) 32 (C. C. A. 9th, 1946);

Bowles v. Abendroth, 151 Fed. (2d) 407 (C. C. A. 9th, 1945).

It has been held that no immunity is granted from criminal prosecution based upon leads or tips obtained from required records subpoenaed by the government.

U. S. v. Shapiro, 159 Fed. (2d) 890 (C. C. A. 2d, N. Y.).

Where the defendant readily turns his records over to government representatives for inspection he cannot claim immunity based upon evidence obtained therefrom.

Bowles v. Glick Brothers Lumber Co., 146 Fed. (2d) 566 (C. C. A. 9th, 1945);

Bowles v. Beatrice Creamery Co., 146 Fed. (2d) 774 (C. C. A. 10th).

RECENT ILLUSTRATIVE CASES

Most of the recent cases involving the problem under discussion arose out of wartime regulatory legislation.

Thus, in *Davis v. U. S.*, 328 U. S. 582 (June 10, 1946), the Supreme Court greatly narrowed the protection of the Fourth Amendment by extending the concept of "public records" for the purpose of a search without a warrant. This case involved the use as evidence of illegal gasoline ration coupons in a prosecution for unlawful possession of such coupons.

The petitioner was president of a corporation which owned a gasoline filling station in New York City, and was suspected by the government of black market operations in gasoline. Accordingly, two O.P.A. investigators drove their car into the station and bought some gasoline at over ceiling price and without furnishing ration coupons. They thereupon arrested the attendant who stated she was following petitioner's instructions. The petitioner then drove into the station and was also arrested on similar charges. The investigators demanded to see petitioner's coupons. They did not have either a search warrant, or a warrant for the arrest of petitioner. Petitioner then informed the investigators that the coupons were in an inner room behind a locked door. The investigators thereupon demanded that he open the door and show the coupons to them on the grounds that the coupons were government property and that he was merely a custodian of them. Petitioner refused to unlock the door at first. But after an hour of questioning, when petitioner noticed an investigator at the window of the inner door, with a flashlight, apparently trying to open the window and force an entrance, petitioner unlocked the door. The investigators found that petitioner had coupons for more gasoline than his tanks would hold. After further questioning petitioner was released, but about six weeks later was arrested on a warrant charged with unlawful possession of gasoline. Petitioner made a motion to suppress the evidence obtained in the room on the ground that it resulted from an illegal search in violation of the Fourth Amendment and that to use such evidence was a violation of the Fifth Amendment. The district court denied the motion on the ground that petitioner had consented to the search. The circuit court of appeals, in affirming the conviction, expressed doubts whether petitioner had consented to the

search but found that the coupons were admissible since the search and seizure were incidental to an arrest.

The Supreme Court affirmed the judgment of conviction and pointed out that the fact that demand was made during business hours at the "place of business" where the coupons were required by law to be kept, the existence of a right of inspection, the nature of the request, the fact that the first refusal to surrender the coupons was followed shortly by acquiescence in the demand, all supported the finding that the accused had voluntarily consented to the search and seizure, and that the Supreme Court therefore could not, as a matter of law, hold that such a finding was error.

The court, per Mr. Justice Douglas, pointed out that the articles seized were public and not private in character, and were required by law to be held subject to inspection, and therefore the investigators did not exceed "the permissible limits of persuasion," that the finding of the district court that defendant consented to the search was not error and that the coupons were properly admitted in evidence.

The court said, at p. 593:

> "The public character of the property, the fact that the demand was made during business hours at the place of business where the coupons were required to be kept, the existence of the right to inspect, the nature of the request, the fact that the initial refusal to turn the coupons over was soon followed by acquiescence in the demand—these circumstances all support the conclusion of the District Court."

With both the majority and the dissenting opinions agreed that the Fourth and Fifth Amendments should be construed together in cases of this kind, the vigorous dissenting opinions by Mr. Justice Frankfurter (in which Mr. Justice Murphy joined) and by Mr. Justice Rutledge met the majority opinion head on. They pointed out that since the offense was a misdemeanor, the production of the coupons was not compellable by subpoena; that the duty to produce public papers does not permit investigators forcibly or fraudulently to obtain them; that there is no merit to the "place of business" argument; and that the finding of consent was unsound "unless one is to hold that every submission to the imminent exertion of superior force is consensual if force is not physically applied." Mr. Justice Rutledge differed

from the majority's conclusion on the ground that consent is illusory when given in the belief that forcible entry and seizure of the evidence would otherwise have resulted; and that submission to search and seizure upon a showing of superior force should not be construed as consent to such search and seizure.

By denying the illegality of the search and seizure in this case the court seems to have rendered more uncertain and unpredictable the extent of the protection by the Constitution of records required by law to be kept.

In *Zap v. U. S.*, 328 U. S. 624 (June 10, 1946), the F.B.I. seized a cancelled check which had been fraudulently made out in an amount greater than actually expended by the holder of a government contract to do certain experimental work for the Navy. The seizure was made under the color of a defective warrant and with the consent of the defendant's employees during his absence.

There was both a statutory and a contractual power of inspection of defendant's records.

The Supreme Court affirmed the conviction on the ground of waiver of immunity, reasonableness of the search, and that if the check were returned on motion to suppress, it could be secured by a warrant as property used "as a means of committing a felony" under the Search Warrant Act. Justices Frankfurter, Murphy and Rutledge pointed out that the requirement of particularity in search warrants entitled defendant to return of the check; that the legality of a search does not automatically legalize every accompanying seizure; that suppressing evidence seized under a defective warrant is not, as the majority stated, an attempt "to exalt a technicality to constitutional levels," but "the fact that this evidence might have been obtained by a lawful warrant seems a strange basis for approving seizure without a warrant."

In *Harris v. U. S.*, 328 U. S. 832 (May 5, 1947) the Supreme Court affirmed a conviction of unlawful possession, concealment and alteration of certain Notice of Classification Cards and Registration Certificates in violation of Section 11 of the Selective Training and Service Act of 1940, and of Section 48 of the Criminal Code, wherein the evidence by which conviction was obtained was found after a very intensive search of defendant's home under a warrant to seize certain cancelled checks

which were used in connection with another crime of which defendant was suspected.

Five agents of the F.B.I., acting under authority of warrants, swooped down upon petitioner and arrested him in his apartment. Following the arrest petitioner was handcuffed and, over his objection, an intensive five hour search of the apartment was made, one agent being assigned to each room. For five hours they literally tore the place apart from top to bottom, going through all of petitioner's clothes and personal belongings, looking underneath the carpets, turning the beds upside down, searching through all the bed linens, opening all the chest and bureau drawers, and examining all personal papers and effects. As the search neared its end, one of the agents discovered in a bedroom bureau drawer a sealed envelope marked "George Harris, personal papers." The envelope was torn open and on the inside was found a smaller envelope containing the draft cards upon which the conviction was based.

Chief Justice Vinson, speaking for the majority, pointed out that the search and seizure was incidental to an arrest, was not a mere exploratory search or fishing expedition, but a search for government property or contraband used as an instrumentality of a continuing crime against the government.

The vigorous dissent by Mr. Justice Frankfurter, concurred in by Mr. Justice Murphy and Mr. Justice Rutledge, pointed out that an intensive search, consisting of the rummaging and ransacking of a home is unreasonable; that a search undertaken illegally cannot retrospectively gain legality from the finding of contraband five hours later, and that lawlessness in law enforcement defeats the very ends of justice.

Justice Murphy contended that the decision resurrected and approved general warrants by converting a warrant for arrest into a general search warrant.

Mr. Justice Jackson dissenting, while disagreeing with the other dissenters that the intensity of the search made it unreasonable, pointed out that: "In view of the readiness of zealots to ride roughshod over claims of privacy for any ends that impress them as socially desirable, we should not make inroads on the rights protected by this Amendment. The fair implication of the Constitution is that no search of premises, as such, is reasonable except the cause for it be approved and the limits

of it fixed and the scope of it particularly defined by a disinterested magistrate."

Bowles v. Beatrice Creamery Co., 146 Fed. (2d) 774 (C. C. A. 10th, Nov. 1944), was an action pursuant to Section 205(e) of the Emergency Price Control Act, to recover treble damages for overcharges in the sale at wholesale of certain poultry items and ice cream, wherein the Circuit Court of Appeals for the 10th Circuit reversed a judgment of dismissal after the District Court had granted defendant's motion to suppress certain evidence consisting of sales records of poultry and ice cream, obtained by O.P.A. investigators from defendants upon a showing of their credentials and a demand for, and voluntary production of, the records.

The court, basing its decision upon the ground that the defendants had voluntarily consented to the examination of the records in question, said:

> "As a means of enforcing a valid law, Congress may require the keeping of records reasonably necessary to that end. To require the keeping of records showing whether there has been compliance with a valid law is an appropriate means to a legitimate end. Such records are quasi-public in character and as to them, the privilege against self-incrimination under the Fifth Amendment does not apply."

Among other things, the Administrator contended that since the defendants were doing business under automatic licenses provided by Section 205(f)(1) of the Act, as such licensees they were under a legal duty to permit the inspection and copying of the records in question when required to do so by the Administrator or his duly authorized representative.

The court conceded that this contention "finds support in U. S. v. Milligan, D. C. N. Y., 268 Fed. 893, a case arising under the Lever Act, and A. Guckenheimer & Bros. Co. v. United States, 3 Cir., 3 F. (2d) 786, involving a wholesale liquor licensee." In further support of the contention that a licensing authority may inspect the records of a licensee without violating the Fourth or Fifth Amendments to the federal Constitution or their counterparts in state constitutions are the cases of *Paladini v. Superior Court,* 178 Cal. 369; *State v. Davis,* 68 W. Va. 142; *People v. Rosenheimer,* 209 N. Y. 115; *State v. Hall,* 164 Tenn. 548; and *State v. Stein,* 215 Minn. 308.,

In *Bowles v. Insel,* 148 Fed. (2d) 91 (C. C. A. 3rd, March 12, 1945), plaintiff sought to inspect defendants' records of meat sales under Maximum Price Regulation 169, and when defendant refused, plaintiff caused subpoenaes *duces tecum* to be issued requiring them to testify and to produce the records, and upon refusal thereof, obtained an appropriate production order from the District Court. The Circuit Court of Appeals affirmed the order to produce the records and said, at page 93:

> "It is perfectly clear, however, that the records required to be produced are not private but public or quasi-public records; and the mere fact that they are records of the sort which a private person would ordinarily keep with regard to his private business transactions does not detract from their public character. It was within the power of Congress, as a war measure, to regulate prices of commodities to guard against ruinous price inflation; and, since the keeping of records open to public inspection was necessary to any effective enforcement of such price regulation, it was well within the Congressional power to require that records of sales and prices be kept and be subject to inspection by public officers."

In *Oklahoma Press Publishing Co. v. Walling Adm.,* 327 U. S. 186 (1946), the court held that allowing the Wage and Hour Administrator to determine coverage under the Fair Labor Standards Act of 1938, 52 Stat. 1060, by the use of his subpoena powers in his preliminary investigation, and with the help of the District Court, if necessary, did not constitute an unreasonable search and seizure. Mr. Justice Murphy in his dissent pointed out that the use of subpoena power by non-judicial officers unarmed with judicial process "is an open invitation to abuse of that power."

Bowles v. Glick Brothers Lumber Co., et al., 146 Fed. (2d) 566 (Certiorari denied by U. S. Supreme Court, June 13, 1945, and rehearing of petition for certiorari denied October 8, 1945), is a leading case, in which the Administrator filed an action for treble damages for alleged overcharges in the sale of lumber at wholesale. The District Court (D. C., S. D. Cal.) granted defendant's motion to suppress certain evidence and to dismiss the action upon the ground, *inter alia,* that the evidence upon which the action was based, was obtained in violation of the Fourth and Fifth Amendments to the Constitution of the United States, and that the Administrator had no right without a

subpoena to examine or copy the sales records of the defendant which were required to be kept by General Maximum Price Regulation No. 215. The Circuit Court of Appeals reversed the District Court.

The court said at pages 570 and 571:

"It is thus seen that dealers are required by the Act to keep such informative records as the Administrator may direct and to permit the Administrator, upon request, to inspect and copy them. These requirements are an essential part of the Congressional scheme of price stabilization and control. It is hard to see how the purposes of this vital wartime legislation could be achieved without them. To effect the end desired Congress clothed the Administrator with regulatory and investigatory powers commensurate with his responsibilities, arming him both with authority to inspect and with the power of subpoena. The regulations on the subject are in harmony with the statute. The records inspected and copied in this instance were of the type required to be kept and to be made available for inspection. They were not private books and papers of the kind involved in Boyd v. United States, 116 U. S. 616, 6 S. Ct.

524, 29 L. Ed. 746, and like cases. They were quasi-public records."

The Circuit Court of Appeals in the *Glick* case did not limit its holding to civil actions but indicated that its conclusions would be the same regardless of whether the Administrator's treble damage action were held to be merely remedial or were regarded as penal in character.

COMMON TACTICAL ERRORS

One of the common tactical errors made by attorneys for trade or industry groups or other clients whose required records are sought by a regulatory agency is to advise refusal of access to such records without the issuance of a subpoena *duces tecum,* and when the books are produced in response to such a subpoena, to claim immunity from criminal prosecution based thereon.

The danger of such advice is twofold. First, is the practical danger that it may create an impression on the regulatory agency of defiance of its regulations by such group, thus inviting redoubled enforcement action in order to prevent a threatened spread of defiance or rebellion against enforcement of the stat-

ute or regulation generally. Perhaps nothing will sooner precipitate increased enforcement action or cause a regulatory agency to "throw the book" at a trade or industry group than organized defiance, particularly if it indicates a possible conspiracy to obstruct the administration of justice.

Second, such advice may lull the trade or industry group into a false sense of security from criminal prosecution, since recent cases seem to indicate that no immunity from criminal prosecution arises from requiring the production of such records by subpoena.

In *Coleman v. U. S.*, 153 Fed. (2d) 400 (C. C. A. 6th, March 28, 1946), the court affirmed judgment of conviction of violation of a ration order and said, at page 403:

> "Appellant seemingly also fails to consider that when he seeks to obtain his share of ration points to run his business, he by that very act opens the door to a check on the truth or falsity of any statements he makes. Wilson v. United States, *supra*, 221 U. S. 384, 31 S. Ct. 538, 55 L. Ed. 771, Ann. Cas. 1912D, 558. He thus assures the government, that has taken control of the distribution of food during the crisis of war, that he will act in accordance with its instructions for the right and protection given him. No one compels this appellant or anyone else to take any certain number of ration points and if appellant had failed to take his requisition no criminal proceedings based upon any Federal law could have delved into his personal affairs to bring forth incriminating evidence. But when appellant decided to take advantage of the privilege the government was extending he agreed to abide by the rules and regulalations thus laying the foundation for a quasi-public relationship."

In *U. S. v. Justman* (S. D. N. Y., April 17, 1945), 3 O.P.A. OP. & DEC. 2062, the court denied defendant's motion to quash certain informations on the ground of immunity from prosecution by reason of the production of books and records before the O.P.A. Administrator in response to a subpoena *duces tecum*.

But see *In re Hoffman,* 68 Fed. Supp. 53 (D. C. of D. C., 1946) (appeal pending), holding that respondent was not subject to punishment for contempt of court for disobedience of an injunction against violation of price regulations where contempt proceeding was based on information obtained from documents which respondent produced in response to subpoena *duces tecum* issued by the Office of Price Administration, even though statutes and regulations required such records to be kept.

In *Bowles v. Misle,* 64 Fed. Supp. 835 (March 9, 1946), an action for injunctive relief and for a judgment based upon overcharges in violation of O.P.A. regulations, the court granted plaintiff's motion requiring defendant to produce and to permit inspection of books and record.

Wigmore, with his usual penetration, has commented on the rule as follows:

> "The generalization, therefore, may be made, that there is no compulsory self-crimination in a rule of law which merely requires beforehand a future report on a class of future acts among which a particular one may or may not in future be criminal at the choice of the party reporting."
>
> *Wigmore on Evidence,* 3rd Ed., Volume VIII, Sec. 2259(c)(2).

CONCLUSION

It appears that the trend is undoubtedly toward permitting governmental agencies to exercise a wider scope of powers in the compulsory inspection and production of required records. How much of this apparent trend arises from a desire to avoid the federal rule of nonadmissibility of illegally obtained evidence, and how much is due merely to wartime exigencies, time alone will tell. Meanwhile, however, the trend seems to continue undiminished.

Indeed, there may even be some truth in the conclusion that, for better or for worse, our federal government, in one way or another, has gradually transformed the protective wall of constitutional guarantees of privacy of records into a triumphal arch!